DOW THEORY LETTERS INC.

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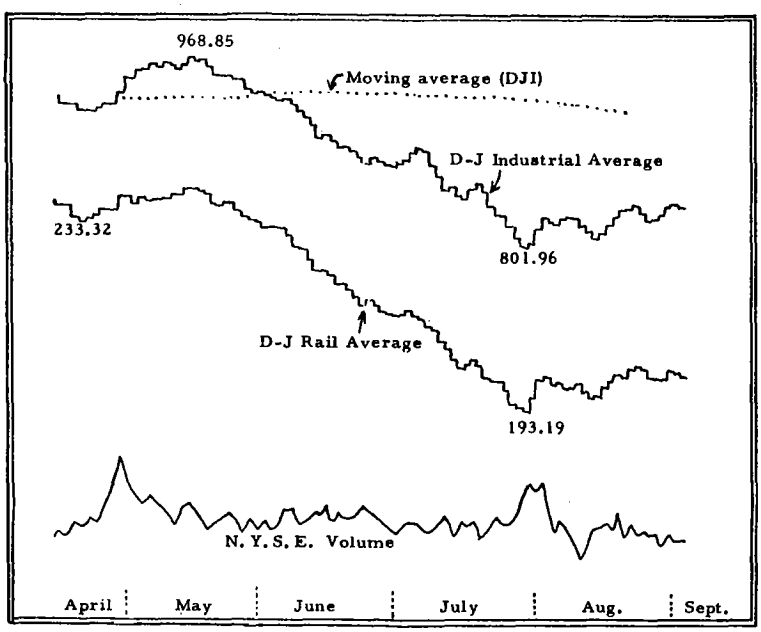
THE MARKET: I was particularly interested in Humphrey Neill's latest "Contrary Opinion" report. In it he notes two widely-held current opinions: (1) That the 800 level needs to be tested before the market can rally, and (2) that the long-term picture is splendid. "In poll after poll," writes Neill, "when the question is asked 'Where will the averages be a year hence,' the answers cluster above 1050 (or some such index number for the Dow) and on up to 1200. Only a small minority forecasts a figure below 800 or 700. You have to hunt to find a prediction of 500-600."

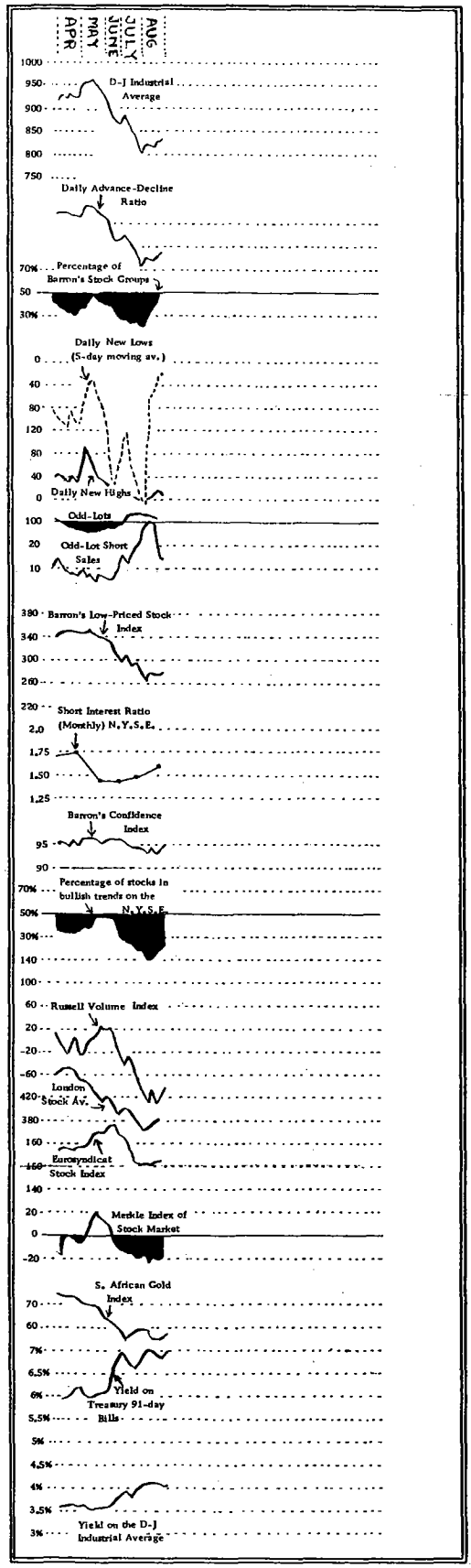
Personally, I agree with both of Humphrey Neill's observations regarding what "everybody is thinking." I also believe that it is entirely possible for the market to provide one of its time-honored double-crosses. If the market decides to fool the majority, we might expect a rally or even a full correction of the 1969 decline (without any testing of the 800 level), and then a wide-open smash through 800, through the 744.32 Industrial low of 1966, and perhaps a continuing decline into the 500 to 700 area.

We started out 1969 with three major trouble areas in progress, Vietnam, domestic inflation and the international monetary problems. None of these areas have been solved, and in fact, it would be hard to make a case for any of these areas being any more hopeful now than they were when 1969 began.

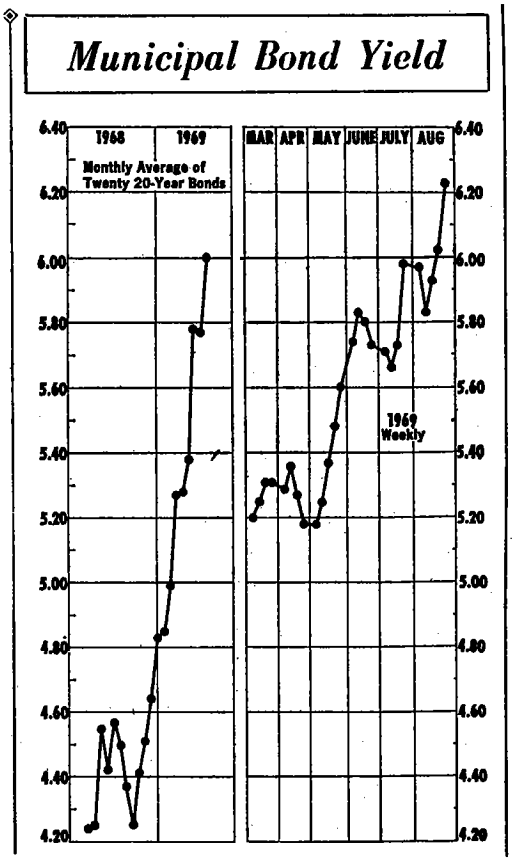
As far as inflation is concerned, the persistence of inflationary price rises seems fated to continue as long as the increased costs of tight money and higher wages can be passed on from one user to the next and ultimately to the consumer. There are indications, however, that that time may be drawing to a close. Physical volume of consumer goods purchased, for instance, is not rising.

Just as important is the continued rise of interest rates, first in one area, then the next. I include the D-J Municipal Bond Yield chart, which rose from last week's 6.02% to this week's all-time record 6.23%. That jump is roughly equal to a drop of $26 on every $1000 Municipal Bond outstanding. Thus, in true primary





bear market fashion, while values in one area rally (this week it was common stocks), values in another area decline (bonds).



Meanwhile, the Nixon Administration is aware that they are facing budgets which are out-of-control, and the San Clemente White House is attempting in every way to pare down expenses. The latest information is that the projected $6.3 billion budget surplus for the current fiscal year is shaky, and that the best that can be looked for is a balance.

My own prediction is that high interest rates together with Governmental cutbacks are going to produce a slide in sales and physical volume which is going to be more and more pronounced as 1970 looms. With costs rising via inflation and with sales leveling off, profits are going to tumble in alarming fashion before this bear market is over.

All in all, I warn subscribers not to trust the current rally in the stock market. It is a technical response to the severe selling which occurred during the first seven months of 1969. I would expect the rally to peter out during the next few months, to be followed by new lows during the fourth quarter of 1969 or during early 1970.

PERCENTAGES: The accompanying long-term chart traces the action of the D-J Industrial and Rail Averages from 1962 to date. I have not written about Dow's 50% Principle for many months, but it may be worth reviewing now.

The Principle states that following an extended movement lasting many months to years, the terminal point of the first major reaction should be noted carefully. If the reaction low holds above the 50% level of the preceding major

advance, then the odds favor a resumption of the major rise and an ultimate testing or bettering of the highs. Conversely, if the reaction low terminates under the 50% level of the preceding major advance, then the odds favor an ultimate testing or breaking of the lows at which the entire upward movement began.

The advance in Industrials from the 1966 low (see chart) to the 1968 high added 240.89 points to Industrials (744.32 to 985.21). The halfway or 50% level of this advance was therefore 864.77. By the same token, the halfway level for Rails during the 1966-1969 advance was 229.91. The 1969 decline succeeded in violating both 50% levels. Under the 50% Principle, the odds would now favor an ultimate breaking of the 1966 lows, which were 744.32 on Industrials and 184.34 on Rails.

The rationale behind the 50% Principle is much like the physical principle which guides the movements of a child's see-saw. If we take the end of the see-saw which is resting on the ground and shove it upwards it will move towards the horizontal. If the upwards push was insufficient, the see-saw will falter short of the horizontal, and the end nearest us will then descend and touch the ground at our feet. However, if the upward shove is powerful enough our end will pass the horizontal position and continue up so that the other side of the see-saw then rests on the ground. This same physical principle often works in the market.

If we see the 1966 to 1969 rise in Industrials as the near end of a see-saw, then the rise took our end of the Industrial see-saw up a distance of 240.89 points. Then during 1969 our end of the see-saw came down, passing the halfway (horizontal) level at 864.77 and continuing to the July 29, 1969 low of 801.96. (Rails not only broke their own 50% level but wiped out 91% of their entire 1966-1969 gains). To stay with Industrials, however, the breaking of the 864.77 level implies, under the 50% Principle, that Industrials should ultimately test or penetrate the level at which the whole 1966-1969 advance began, the 744.32 level. In time, probably within the next six months, we will see whether the 50% Principle works, saying as it is that the odds now favor a return to or below the 1966 lows.

WHAT, WHERE? In all the years I have been watching Wall Street, I have never seen a more dramatic period of economic confusion. The question: have the Administration's economic advisors thrown in the sponge on the economic picture or do they still believe they know what is going on?

Over the past few weeks everyone has been trying to figure out what has been happening to the U.S. money supply. The Administration's economic brain trusters are more-or-less followers of Milton Friedman and the Chicago school, which holds that the rate of the money supply is the great economic tool with which to boost or hold back the economy. Thus, it is no small matter when officials can not get an approximation of what is happening to money.

Dr. Friedman himself notes that the money supply has grown at a rate of only 3.2% from April to July. That compares with 4.8% for the previous six months. But looking at another measure, currency plus demand and time deposits (except C/D's) shows a rate of increase of only .7% from April through July. This rate, states Friedman, is too severe, and it poses the threat of economic recession.

But Paul McCracken, Chief of Nixon's Economic Advisers, is not convinced that money is too tight. Confusion was compounded, however, when the original rate of 2.4% increase in the money supply was revised to show that the actual rate is more like 4% for the first seven months of 1969. Either way, this is a decline from last year's revised figures of 6.5%. But with the massive supply of Eurodollars and C/D's, no one is sure just what is actually happening to the money supply. The C/D's and Eurodollars fouled up the demand-deposit component in the money supply.

Perhaps the whole situation was best summed up by Mr. McCracken when he commented last week, "having about now finally acclimated ourselves to calibrating the Federal Reserve policy by rates of monetary and credit expansion rather than interest rates, we now find the figures themselves falling apart on us." He added, "This is an awkward time to have so much dust in the air. It is perhaps not being excessively bold to suggest that there is apparently as much uncertainty about where we have been as where we ought to be going."

On top of the money supply confusion, new uncertainties are being created in the spending sphere and in the tax area. Congress is currently working on a tax bill which will siphon off money from the rich and the corporations and spread it around to the not-so-rich. At the same time military spending is being cut so that, for instance, I note that spending was $31.7 billion for prime military contracts in the second quarter of 1969, down $13 billion or 29% (yes, twenty-nine per cent) from the 1968 period.

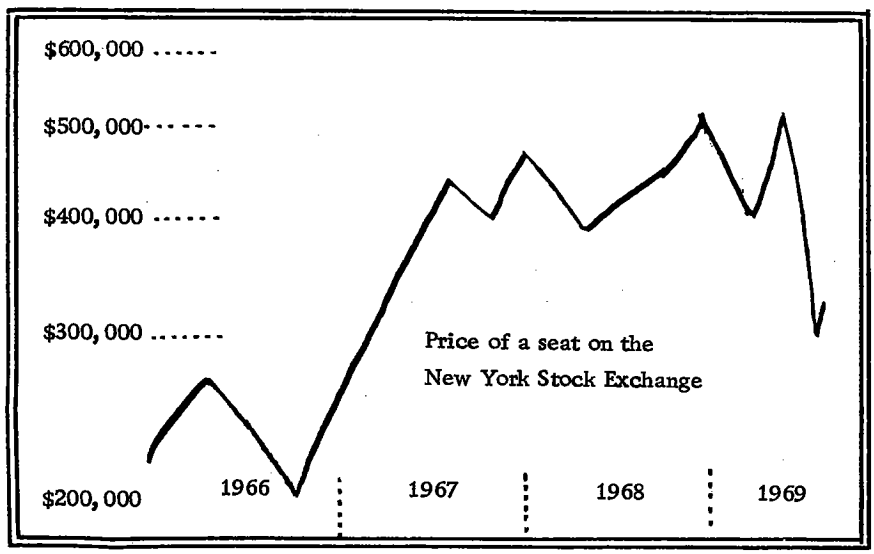
Then last week exit-ing William Chartener of the Commerce Dept. stated that inflation would run at 5% for the rest of 1969. Differing with him, Mr. McCracken noted that inflation should begin to subside by the end of the year. Moreover, McCracken said that now is not the time for any easing up on monetary conditions and many believe that McCracken would actually prefer to tighten still further on the money supply.

My friend Eliot Janeway sounds an ominous warning. First stating that it now requires roughly $2 in debt to produce every $1 in G.N.P., Mr. Janeway writes in his latest report, "When an economy geared to depend for its momentum on debt is deprived of the power to create debt, it is exposed to crash." Further, Janeway believes that "the orthodox remedies, on which the Fed's management of the Administration has insisted and in which Fed management has believed, have failed to check the cost-price push; they have also created a condition of insolvency inside the mechanism of the financial structure which is guaranteed to accelerate inflation." Finally, Janeway notes that because of the increasing insolvency it is possible that Treasury tax collections will fall off over the foreseeable future. If that happens, we can forget about any lows we have seen so far in the bond markets.

So there it is, one of the most dramatic periods in American finance, with the experts and the statistics at odds, and with the stock market hanging above the recent lows in a stance of nervous expectancy. As one of the Gotham reviewers once said of a gala Broadway production, "I call it a hellova show."

COLD SEAT: During a primary bear market, it isn't only the public that loses. Bear markets are always unpopular on Wall Street, and one reason is that members of the New York Stock Exchange have a tidy little investment in their Exchange seat or membership.

The price of a seat tends to fluctuate with Exchange volume, since obviously the more volume the more profitable a seat on the Exchange. Historically, the low price for a seat was $4,250 in 1875. At the turn of the century a seat sold for $47,500. During 1906 a seat sold for a record $95,000 just before the 1907 panic. At the 1907 low, seats had declined to $51,000.



By 1921 a record $115,000 was paid for a seat. Seat prices dropped to $76,000 during the 1923 recession. The all-time high for a seat came in 1929 at $615,000. By 1932 a low of $68,000 was paid for a seat. With the return of speculation, a seat in 1936 sold for $174,000. Following the 1937 crash and the ensuing poor markets, seat prices declined drastically. By 1941, with World War II about to start and with Exchange volume running at one million shares or less per day, a seat sold for a low of $19,000. An unbelievable low of $17,000 was established in 1942.

During the 1946 speculation seat prices got up to $97,000. During the 1946-49 declines seat prices dropped, setting a low of $35,000 in 1949. From then on it was up and up. By 1950 the top price for a seat was $54,000. In 1960 a seat sold for $162,000. Then the real enthusiasm occurred. A seat went for $270,000 in 1964, and from there on my chart takes over. In January, 1969, two seats sold for $515,000. By March seat prices had declined to $400,000. A new rally came in, but by early August, 1969, a seat sold for as low as $300,000.

The 1969 drop from $515,000 for $300,000 represented a drop of 42%, and figuring that there are currently 1,366 seats on the N.Y.S.E., this means a total paper loss of nearly $294 million for the collective members of the New York Stock Exchange. Is there any wonder that Wall Street's most selective club hates a bear market? Personally, I would guess that it might be many years before the 1969 high of $515,000 is seen again for an Exchange seat.

COLLISION: The biggest event of the past month, in my mind, was not the fluctuations of the New York Stock Exchange. It was the message of what has been termed, "history's biggest happening." The happening was the gathering of over 400,000 youths at Bethel, New York, an event which cost the promotors an estimated $1 million and made headlines in magazines and newspapers across the country.

I cannot help but compare the steady, relentless march of inflation, the sick, eating away of the money and savings of this nation, with this massive meeting of the country's youth in a rock sponsored, drug-oriented meeting which caused the adult population of America to sit up and blink its eyes. For if the youth of the country is occasionally given to getting high on drugs, the adult population has had its eyes blinded by a different kind of drug for many years.

When I was a high school kid in New York City the mechanism of protest was black music, jazz; and those who wanted to get away from the hypocritical values of the times would slip up to Minton's or Small's in Harlem and lose themselves in the strange, exciting music of the black sub-culture. But this was a very limited phenomenon, and the mass of American youth in the 1930's and '40's was struggling to adjust itself to the tides of the World War or simply intent on getting a job and surviving. Depression and recession were characteristic of the times, and staying alive occupied most of one's waking hours.

With the opulence of the 1960's, with the rising prevalence of wealth— greed, inflation, self-satisfaction and pride, the youth of America has developed a massive form of sub-culture protest— rock music and drugs. But behind this surface manifestation is a deep, burning wish to change the values which their parents live by. Those values were inflicted on them without discussuion, without a choice. Youth wants the choice— and they will get it.

Kids from all types of families, Eastern, Mid-Western, Western, Southern, wealthy, poor, middle class, black and white, have turned against the values which perhaps can best be seen in the whole sick, Vietnam phenomenon. There is no leader for the new youth movement. It is no giant communist plot, it is no incipient violent revolutionary threat to the present Government. After all, in a decade or so today's "youth" will be our Government.

As Janis Joplin, "Queen of Rock" stated, "We don't need a leader. We have each other. All we need is to keep our heads straight, and in ten years this country may be a decent place to live in."

What does she mean, a decent place to live in? Don't we have the highest standard of living in the world. Didn't we send three men to the moon in 1969? Hasn't this nation captured the imagination of the world? If you're asking yourself those last three questions or questions like it, you're in trouble. You don't know what the Bethel happening was all about. And you don't see the great, coming social phenomenon of our times. That phenomenon is a questioning of values. It is the biggest "why" in American history. And it's being asked by your kids. Maybe you better talk to them; you'll get a hint as to what's coming up.

ECONOMIC SCRAPBOOK:

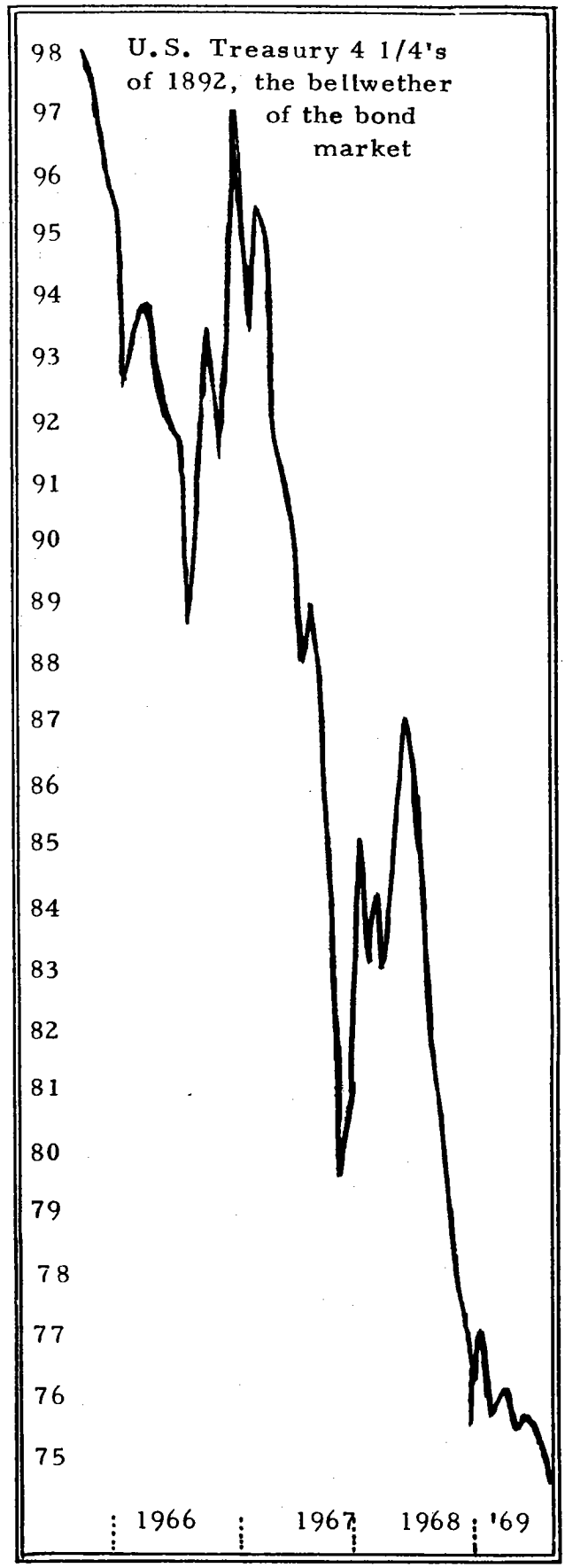
August 27.....Average mortgage rates rose to a record 7.90% as savings & loan associations suffered a $1.03 billion cash drain, far above the previous record drain of $772 million in June, 1966.
Pointing to more inflation, the nation's 1000 corporations plan a 12.6% increase in capital spending.

August 28.....William Chartener, top economist for the Commerce Dept., predicted (to the undoubted consternation of the Administration) that inflation will continue at a 5% rate throughout the rest of 1969.
The U.S. posted a trade surplus of $105 million in July, down from $132 million a year ago.
Construction contracts fell 2% in July from the June level.
Duke Power's Aaa bonds went for a yield of 7.95% for investors, a new record.

August 29.....If conditions "continue to show improvement," says the N.Y.S.E. it will go back to five hour sessions instead of the present four-and-one-half (see section on N.Y.S.E. seat prices!).
The Fed kept money tight with borrowed reserves at the banks at $1.04 billions.

September 2.....Labor Secretary Shultz stated that the Administration may have to escalate its war against inflation.
AFL-CIO Pres. Meany said that only mandatory wage-price controls would stop inflation.
The D-J 40-Bond Average dropped to new low for the year— and the lowest level since 1934.
New factory orders in July were 2.3% above June's level, to a record.

CHART OF THE WEEK: I am taking a lot of space to show this chart of the bellwethers of the U.S. Treasury bond market, the 4¼'s of 1987-92. On September 2 these bonds closed at 74 9/16's bid, to yield 6.33% at the market. When a stock like DuPont or Anaconda caves in, it is a sad thing for investors, but no one can call it shameful. But when the debt of the U.S. Government, as represented by the 4¼'s of 1987-92 sell at less than 75¢ on the original $1, it is shameful. These bonds were not issued in 1946 or 1956. They came out in 1962, which gives you some idea of how our Governments and Government agencies have been protecting our money. If any readers of these Letters even suspects that the dollar is as good as gold, just study this chart.



In 1965 those who turned in dollars for gold (foreigners) saw the value of that gold go up to the current $41 on the free market, a rise of 17%. And this while gold is still the cheapest commodity around. Those who purchased the 4¼'s at the end of 1965 saw their bonds lose around 25% of their value. In other words, recent history suggests that the dollar and the debt of the U.S. Government are far from "as good as gold".

Actually, I have been warning for some time that the bond market had probably not completed its bear market decline. It should be remembered that most bear markets in bonds terminate amid widespread credit distress and even chaotic credit conditions. That phase has not yet arrived. But last week municipal bonds, the D-J 40 Bond Average and selected Treasury bonds went to record lows. The bear market in bonds continues.

QUOTES TO REMEMBER: "The big riddle on the inflation is growing steadily more perplexing." (Time Mag., August 29).

"Something funny is happening on the way to inflation control. It's not behaving the way it should." (Christ. Sc. Monitor, August 30).

"There are eerie signs of an upswing." (Newsweek, August 25).